

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0276
Gross Income Tax
For the Year 1996-1999

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ISSUES

I. Gross Income Tax -- Leasing income

Authority: Ind. Code § 6-2.1-2-2; 45 IAC 1-1-162 (repealed effective January 1, 1999); 45 IAC 1.1-3-13; *First National Leasing v. Ind. Dep't of State Revenue*, 598 N.E.2d 640 (Ind. Tax 1992).

Taxpayer protests the imposition of gross income tax with respect to lease income received from a trust.

II. Tax Administration -- Negligence Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is engaged in a variety of businesses, including the leasing of tangible personal property, operated through a grantor trust. During the years in question, the trust engaged in two types of leases. The first type, "M Leases," generally covered ordinary tangible personal property, some fixtures, and construction equipment. The second type, "R Leases," covered larger, mobile items of tangible personal property, as well as plant equipment and power plant generators.

During the years in question, Taxpayer did not report its income from the trusts on its corporate income tax return. However, as a result of a Department audit, the Department assessed additional tax with respect to the income generated from the leases. In addition, the Department assessed a negligence penalty of ten percent. Taxpayer has protested the assessments of both tax and penalty.

I. Gross Income Tax -- Leasing Income

DISCUSSION

In general, the gross income of a non-resident taxpayer derived from activities or businesses in Indiana was subject to a gross income tax prior to January 1, 2003. Ind. Code § 6-2.1-2-2. Trusts that resembled corporations in form and carried the purpose of conducting a trade or business were subject to tax as corporations. 45 IAC 1-1-162 (repealed effective January 1, 1999); *see also* 45 IAC 1.1-3-13 (effective January 1, 1999). Based on the facts of this case--inasmuch as the lease income was constructively received by Taxpayer--the Department appears to have actually underassessed tax rather than overassess tax against Taxpayer.

Taxpayer argues that its income derived from R Leases is not subject to gross income tax due to Taxpayer's (and the property's) lack of nexus with Indiana, and the fact that its power plants would not generate net income for several years. Taxpayer cites *First National Leasing v. Ind. Dep't of State Revenue*, 598 N.E.2d 640 (Ind. Tax Ct. 1992) for the proposition that its income from the leases should be exempt from gross income tax. In *First National Leasing*, First National leased equipment used by Hulcher, a wholly-owned subsidiary of First National. Some of the equipment leased by Hulcher was located at a Hulcher base located in Indiana. The companies negotiated their leases outside Indiana, and First National did not control the location of the property that it leased. The court held that First National's income from leasing was not derived from Indiana sources.

First, Taxpayer's net income, rather than its gross income, appears to have been taxed. Second, with respect to its nexus argument based on *First National Leasing*, Taxpayer has not sufficiently developed this argument to show whether its activities were exempt from tax, and accordingly is denied.

FINDING

Taxpayer's protest is denied.

II. Tax Administration -- Negligence Penalty

DISCUSSION

The Department may impose a ten percent negligence penalty. IC 6-8.1-10-2.1 and 45 IAC 15-11-2. Generally, a taxpayer's failure to pay taxes determined by a Department audit will result in penalty assessment. IC 6-8.1-10-2.1(a)(3). However, the Department may waive this penalty if the taxpayer can establish that its failure to file "was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). A taxpayer may demonstrate reasonable cause by showing "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...." *Id.* With respect to the penalty, Taxpayer has not provided sufficient information to permit penalty waiver.

FINDING

Taxpayer's protest is denied.